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Finance and trade*

Report of the Secretary-General

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* The present report was prepared by the United Nations Conference on Trade and Development as task manager for chapter 2 of Agenda 21 and the Department of Economic and Social Affairs of the United Nations Secretariat as task manager for chapter 33 of Agenda 21, with contributions from other United Nations agencies and international organizations. The report is a brief factual overview, which intends to inform the Commission on Sustainable Development on key developments in the subject area.

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Introduction

1. The present report addresses the thematic cluster of finance and trade for sustainable development and reviews the progress achieved in the implementation of the objectives for trade, as set out in chapter 2 of Agenda 21,[1] and for finance, as set out in chapter 33 of Agenda 21. Both issues were addressed most recently by the Commission on Sustainable Development in 2000 at its eighth session. Section I addresses issues relating to finance and reviews general trends in finance for sustainable development. Section II addresses issues relating to trade and sustainable development, focusing on efforts to integrate trade policies and environmental policies, particularly within the context of the World Trade Organization and the United Nations Conference on Trade and Development (UNCTAD), where trade-environment linkages have been a major issue during the 1990s.

I. Finance

A. International finance for sustainable development

1. Official development assistance

2. Between 1992 and 1997, total official development assistance (ODA) from the Organisation for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) member countries to developing countries and multilateral institutions fell steadily from 0.33 per cent of donor country gross national product (GNP) to 0.22 per cent, far below the United Nations target level of 0.7 per cent of GNP. In 1998, there was a slight reversal of this trend, with ODA increasing to 0.23 per cent of GNP for 1998 and 0.24 per cent for 1999.[2] Part of this increase is expected to be transitory, but part reflects a commitment by some donor countries to increasing their aid flows.

3. There have also been changes in the allocation of ODA. During the 1990s, some assessments of aid effectiveness concluded that aid was effective in some national policy environments, but not in others. As a result, there have been sharp cuts in ODA to some countries, but only modest cuts to others whose policies were considered by donors to be more conducive to aid effectiveness. Some countries experienced cuts of at least 50 per cent in aid per capita between 1990 and 1998.[3]

4. In addition to the changes in allocation among countries, there have also been changes in the sectoral allocation of ODA, in particular to critical areas of sustainable development. The shares of ODA allocated to environmental protection and basic social services approximately doubled from 1990 to 1998 for both bilateral and multilateral ODA, with a consistent rising trend over the period. Nonetheless, in 1998 the combined share for those two categories was under 12 per cent of total bilateral commitments and below 8 per cent of multilateral commitments.[4]

2. Private international financial flows

5. In the area of private international financial flows, there have been rapid increases in foreign direct investment (FDI) over the past 10 years. Global FDI outflows reached $800 billion in 1999, an almost fourfold increase from the 1988-1993 average.[5] The number of transnational parent firms in 15 developed home countries increased from about 7,000 at the end of the 1960s to some 40,000 at the end of the 1990s, and the gross product associated with international production by transnational corporations is now about 10 per cent of global gross domestic product (GDP), up from about 5 per cent in 1982.[6]

6. The globalization of investment and production is in part a result of changes in national policy frameworks. According to the United Nations Conference on Trade and Development (UNCTAD), during the period 1991-1999, of 1,035 changes worldwide in laws governing FDI, 94 per cent created a more favourable framework for FDI.[7] Most of the new measures in developing and transition economies reduced restrictions on foreign investment in sectors or industries earlier closed or restricted with respect to FDI. Restrictions on land ownership, employment of foreigners, and foreign exchange controls were also reduced or removed. There have also been large increases in bilateral investment treaties and double taxation treaties over the period from 1980 to 1999.

7. For some developing countries, particularly middle-income countries, private financial flows are the largest source of external finance for sustainable development. Net FDI flows to developing countries had grown steadily through the 1990s to reach $126 billion in 1999, up from about $20 billion in 1990.[8]

FDI flows, however, remained highly concentrated. Ten developing countries received 80 per cent of total FDI flows to the developing world, and there is no indication that that concentration is declining.[9] However, in many of the least developed countries, even though FDI flows are small compared with those to other countries, they are still important in relation to domestic investment.

8. While FDI flows to developing countries have grown steadily, portfolio investment flows and bank flows have shown great volatility. Net portfolio investment in developing countries reached a peak of $90 billion in 1994 and then fell to almost nothing in 1998 before recovering somewhat in 1999.[10] Other private flows to developing countries, primarily bank lending, have fluctuated from net inflows of about $70 billion in 1991, to net outflows of $36 billion in 1994, inflows of $80 billion in 1995 and outflows of $77 billion in 1999.[11]

3. External debt

9. Unsustainable external debt has increasingly been recognized as a constraint on the ability of poor countries to pursue sustainable development. In response, in 1996, the World Bank and the International Monetary Fund (IMF) launched the Heavily Indebted Poor Countries (HIPC) Initiative, endorsed by 180 Governments. In 1999, the Enhanced HIPC Initiative was adopted to provide debt relief that would be "broader, deeper and faster". As of end-December 2000, of the 37 HIPC countries identified as having unsustainable debt, 22 countries had been approved for debt relief under the Enhanced HIPC Initiative, 13 were classified as post-2000 decision point countries and 2, at government request, were not seeking debt relief.[12]

10. Challenges faced by the Enhanced HIPC Initiative include ensuring the principle of additionality of resources for the HIPC programme; overcoming the financial difficulties for some creditor participants in providing debt relief; and developing effective poverty reduction programmes in the participating countries. Debt relief under the Initiative is linked to recipient countries' preparation of a comprehensive poverty reduction strategy, based on rapid, sustainable growth and improvements in social services.

B. Domestic finance for sustainable development

11. Financing sustainable development requires the mobilization of domestic investment, even in countries able to attract substantial external private investment. During the 1990s, in order to promote both domestic and foreign investment, many developing countries undertook fiscal and monetary reform. They lifted controls on interest rates, reduced Government-directed credit, developed new instruments for long-term investment financing, and built more effective regulatory and supervisory structures for the financial sector.

12. There is increasing experience in both developed and developing countries with environmental taxes and charges, which generate revenues, improve resource productivity and confer environmental benefits. However, the fact that their implementation requires strong institutions in the financial and environmental sectors represents a major barrier to their use in many developing countries. Revenue from environmental taxes is still low in most countries. However, the use of environmental taxes has increased in some States members of the European Union (EU).[13] Data from 21 OECD member countries show that revenues from environmentally related taxes ranged between 1.0 and 4.5 per cent of GDP in 1995.[14]

13. Subsidies, of which a large majority promote unsustainable development, are estimated at over $600 billion per year worldwide, and may be as much as $800 billion, of which perhaps two thirds are in the developed countries.[15] Reducing subsidies that promote unsustainable development can both reduce environmental harm and free substantial resources for investment. Subsidies in many developing countries and economies in transition have been reduced during the past decade, usually as part of a liberalization process. However, subsidy reduction is complex politically, as it inevitably means that some groups, often politically influential, will suffer economic losses.

14. The private sector has the potential to play a greater role in financing for sustainable development. However, there is still limited understanding of the best ways to mobilize that potential under various economic, political and social conditions. Privatization is increasingly being used to finance infrastructure provision and the experience with private provision of

previously public sector services has generally been good with respect to the economic dimension of sustainable development. Evidence on the environmental and social impacts is less clear.

C. New financial mechanisms

15. Agenda 21 challenged the international community to find substantial new funding to help countries — particularly the least developed — to pursue sustainable development. The past 10 years have witnessed the development of innovative instruments for sector finance, especially for infrastructure such as power, water, sanitation and public transport. Financial markets have evolved in a complementary way by developing innovative financing instruments, including public-private partnerships, new forms of credit guarantees, subnational financing without sovereign guarantees, new microfinancing mechanisms for the informal and rural sectors, and joint ventures. In addition, the Clean Development Mechanism (article 12) of the Kyoto Protocol (FCCC/CP/1997/7/Add.1, decision 1/CP.3), annex to the United Nations Framework Convention on Climate Change (A/AC.237/18 (Part II)/Add.1 and Corr.1, annex I) may be an important source of finance for sustainable development, but the mechanisms still need to be elaborated.

16. The Global Environment Facility (GEF) has been an important source of new funding. The GEF was transformed from a pilot facility in 1991 into a global partnership with 167 countries as members. It has over 806 projects that stretch across more than 150 developing nations and countries with economies in transition. Nearly $3.2 billion has been allocated to these initiatives, matched by almost $8 billion more in co-financing. The GEF is the designated "financial mechanism" of the Convention on Biological Diversity[16] and the United Nations Framework Convention on Climate Change. The GEF was also identified, in December 2000, as the principal entity for the interim financial mechanism of the draft Stockholm convention on persistent organic pollutants.

17. The GEF contributing participants have twice replenished the GEF Trust Fund. In 1994, 34 donors pledged $2 billion over four years for a restructured GEF as called for in Agenda 21. In 1998, 36 donors pledged $2.75 billion to fund GEF's work into the new millennium. The GEF has initiated negotiations for its third replenishment which are expected to be completed in February 2002. GEF also leverages funds from other sources and mainstreams action on the global environment into the programmes of other international institutions, Governments and the private sector.

D. International Conference on Financing for Development

18. In December 1999, at its fifty-fourth session, the General Assembly decided to convene a high-level international intergovernmental event on financing for development.[17] On 23 February 2001, the Preparatory Committee for the High-level International Intergovernmental Event on Financing for Development, at its second substantive session, recommended to the Assembly the adoption of a draft resolution in which the Assembly would decide that the event would be called the International Conference on Financing for Development and would be hosted by Mexico.

19. The Conference is scheduled to take place in early 2002 and will consider national, international and systemic issues relating to financing for development in a holistic manner in the context of globalization and interdependence. The Conference will address development through the perspective of finance, as well as the mobilization of financial resources for the full implementation of the outcome of the major United Nations conferences and summits of the 1990s. An analytical assessment of the issues to be addressed at the Conference is given in the report of the Secretary-General to the Preparatory Committee for the High-level International Intergovernmental Event on Financing for Development.[18]

II. Trade

A. Trade and trade-offs

20. International trade has increased dramatically since the United Nations Conference on Environment and Development. Although the developed countries are still the main world traders, the share of developing countries in total world trade has reached 30 per cent. Trade among developing countries has also been on the rise, with more than 40 per cent of their exports being

sold to each other. The advent of the "new economy" has increased dramatically the tradability of goods and services. Many international transactions, which previously would have been considered prohibitively expensive, have now become commonplace because of the ease with which people can travel and communicate electronically across national boundaries.

21. These developments, however, need to be kept in perspective. A large share of trade flows has been intraregional and intra-firm. Efforts by developing countries to become full participants in an increasingly interdependent global economy have been hindered by biases in the trading system. Developing-country exporters have struggled to gain access to the markets of the developed countries. The continuing decline of commodity prices — and the terms of trade — represented a major challenge, particularly to the least developed countries. The extreme price movements previously suffered by commodity producers have started to affect manufacturers as well.

22. The past decade has brought a great expansion of multilateral, regional and unilateral trade liberalization. Liberalization under the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization has led to significant tariff reductions as well as stronger and more comprehensive trade rules. However, high tariffs have persisted in some sectors of particular importance to exporters in developing countries.[19] Higher tariffs on processed products than on raw materials have also remained an issue for a number of raw material-based products, making it difficult for developing countries to enter into industrial exports. Despite multiple efforts at reform, many of the poorest developing countries have not been able to share in the benefits of the liberalization process. The majority of least developed countries have failed to achieve economic growth and to integrate into global markets.

23. International economic integration through trade has had important environmental implications. Increasingly, market forces have rewarded good environmental performance rather than cost savings at any price. In large part, this phenomenon has been due to the efforts of businesses and civil society around the world that have made consumers sensitive to the environmental profile of products and the environmental performance of producers. Growing consumer preference for environmentally friendly products (EFPs) has offered new trading opportunities for developing countries. Indeed, a number of developing countries have expanded exports of EFPs as well as "fair trade" products.

24. Available data seem to reject the assertion that polluting industries have been migrating from developed to developing countries, although there have been exceptions.[20] The main vehicles of trade — transnational corporations — have generally preferred reaping the economies of scale of standardization in environmental management systems in their foreign affiliates rather than exploiting weaknesses in local legislation.[21] The largest transnational corporations have increasingly been committing themselves to voluntary principles and standards of corporate social responsibility, tapping on their large, and largely unexplored, potential to contribute to sustainable development.

B. Policies and politics

25. Environmental policies and institutions, including supporting regulatory instruments, have been important determinants of the environmental impacts of trade. Certain progress has been made in promoting environmental impact assessment procedures at the national level and indirect policies such as land-use policies, taxes and other financial incentives, and government procurement. However, policies directly affecting trade and the environment, for example, those on technology transfer, financial assistance and capacity-building, have been lagging behind.

26. In certain cases, the integration of markets has also led to the "integration" of market failures, including those relating to public goods. The continuing dismantling of economic borders has reinforced the need for cooperation in environmental matters, especially those with transboundary or global implications. Managing the interactions between trade and the environment has been one of the areas where Governments have tried to develop new forms of international cooperation to correct market failures and deal with other distortions arising from domestic policies.[22]

27. Even before — and certainly after — the United Nations Conference on Environment and Development, trade policy decisions have been influenced by environmental interests. However, there has been little progress on the trade and environment agenda. Some

particularly in developing countries, viewed environmental issues primarily as a concern of the developed countries, yet very few developed countries have taken consistent action to integrate environmental protection into trade policies. Developing countries have expressed fears that environmental issues might be used to create new barriers to trade and thwart hard-won gains in market access, effectively turning environmental protection into trade protectionism.

28. Part of the problem in integrating environmental and trade policies was that some people regarded environmental measures as ends in themselves, rather than as an essential component of sustainable development. Environmental protection and economic development were often viewed as separate issues, and those who argued for environmental causes failed to address the urgent need to generate wealth to provide for the essential needs of poor people, particularly in developing countries, and vice versa.

29. Attempts to establish a link between environmental issues and labour standards in the trade policy debate have complicated efforts to address either issue. These attempts were made, in part, because the two issues re-emerged in the trade policy agenda at about the same time in the 1990s, and also, in part, because those primarily interested in trade liberalization tended to view both environment and labour as equally extraneous to what they considered the central issues. This attitude, based largely on trade concerns, overlooked important differences between the two issues in terms of their actual and potential cross-border impacts as well as the principles involved.

30. The starting point for the United Nations Conference on Environment and Development-related debate on trade and environment was a series of contentious trade disputes.[23] The GATT/World Trade Organization dispute settlement procedure was viewed by the environmental communities in some countries as a threat to environmental policy-making and, in particular, to the use of trade measures to support environmental objectives. On the other hand, some proponents of trade liberalization were concerned that the use of trade measures for "extraterritorial" environmental objectives could undermine the multilateral trading system and its economic benefits.

31. The growing public anti-trade sentiment that followed was a difficult setback for GATT, which was trying to conclude the Uruguay Round of multilateral trade negotiations. The need to build confidence in trade liberalization and to make a contribution to the United Nations Conference on Environment and Development prompted GATT to focus on examining trade provisions in multilateral environmental agreements (MEAs) vis-à-vis GATT principles and provisions, on transparency of national environmental regulations likely to have trade implications, and on trade effects of new packaging and labelling requirements aimed at protecting the environment. Following the United Nations Conference on Environment and Development, the GATT/World Trade Organization trade-environment agenda was expanded to include matters raised in Agenda 21 with a view to making trade and environmental polices mutually supportive. With the establishment of the World Trade Organization, the GATT Group on Environmental Measures and International Trade was upgraded to a World Trade Organization Committee on Trade and Environment to reflect the broadened scope of the World Trade Organization Agreements.[24] A number of important trade and environment issues found their way into the World Trade Organization "built-in agenda", which goes beyond those Agreements to include new negotiations in some areas such as agriculture and services, and assessments of the situation at specified times in other areas.

32. While the Uruguay Round was being negotiated, many major international environmental agreements were also being elaborated, culminating in the United Nations Conference on Environment and Development and the signing of the United Nations Framework Convention on Climate Change and the Convention on Biological Diversity. The complex structure of the international environmental regime has progressively involved the United Nations Environment Programme (UNEP) and numerous other public and private actors. Promoting synergies between the World Trade Organization and MEAs, and developing an institutionalized, predictable, widely accepted approach to the use of trade measures for environmental purposes have become a major issue.

C. Science and the public

33. Much disagreement on the issue of trade measures for environmental protection in recent years has concerned the relative importance to be given to science and societal preferences. The precautionary

principle"[13] has gathered considerable international support and has found its way into a number of international environmental instruments, most recently the Cartagena Protocol on Biosafety (adopted by the Conference of the Parties to the Convention on Biological Diversity on 29 January 2000 (decision EM-1/3)). Among the relevant World Trade Organization instruments, the Agreement on the Application of Sanitary and Phytosanitary Measures specifically addresses situations of scientific uncertainty. In addition to scientific assessment of risk, other factors also play a role in the decision-making process, including potential liabilities faced by decision makers, the costs of precautionary measures, the acceptability of risks, which can vary within society and among countries, and social concerns and public participation. How to reconcile these factors is a question of ongoing debate.

34. The post-United Nations Conference on Environment and Development debates concerning trade liberalization and environmental protection have amply demonstrated the need for broad public support for progress in integrating the two objectives. Environmental and development non-governmental organizations, together with other institutions of civil society, have been able to mobilize sufficient public sentiment to disrupt multilateral economic and trade negotiations. The High-level Symposia on Trade and Environment, and Trade and Development, convened by members of the World Trade Organization in 1999, were an important precedent towards bringing together the trade, environment and development communities, clarifying the role of the World Trade Organization in environmental matters, and reconciling trade and sustainable development policies and objectives.

35. Although a large proportion of the recent public debates over trade and environment issues have been based on misunderstandings, the debates have brought to the fore valid concerns about the impact of trade liberalization on human well-being and environmental quality. They have also demonstrated that continued conflict between the environmental and trade communities would be harmful to the goals of both.

Notes

[1] *Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992*, vol. I, *Resolutions Adopted by the Conference* (United Nations publication, Sales No. E.93.I.8 and corrigendum), resolution 1, annex II.

[2] Organisation for Economic Cooperation and Development (OECD) Development Assistance Committee (*http://www.oecd.org/dac*), December 2000.

[3] World Bank, *Global Development Finance 2000* (Washington, D.C., May 2000), box 3.1.

[4] Background paper No. 2 entitled "Financial flow statistics" (DESA/DSD/2000/2), prepared for the eighth session of the Commission for Sustainable Development.

[5] UNCTAD, *World Investment Report 2000*, (United Nations publication, Sales No. E.00.II.D.20), annex table B.2.

[6] Ibid., overview, p. xvi.

[7] Ibid., p. xv.

[8] Report of the Secretary-General entitled "Towards a stable international financial system, responsive to the challenges of development, especially in the developing countries" (A/55/187), table.

[9] UNCTAD, *World Investment Report 2000*, p. xvi.

[10] Report of the Secretary-General entitled "Towards a stable international financial system, responsive to the challenges of development, especially in the developing countries" (A/55/187), table.

[11] Ibid.

[12] Heavily Indebted Poor Countries (HIPC) website, *http://www.worldbank.org/hipc/*, 22 December 2000.

[13] Background paper No. 15 entitled "Finance for sustainable development: testing new policy approaches" prepared for the eighth session of the Commission for Sustainable Development, containing the article entitled "Overview of recent experiences with ecological tax reforms in Europe", by Kai Schlegelmilch, p. 185.

[14] Report of the Secretary-General entitled "Financial resources and mechanisms" (E/CN.17/2000/2), para. 59.

[15] Background paper No. 15 entitled "Finance for sustainable development: testing new policy approaches" prepared for the eighth session of the Commission for Sustainable Development, containing the article entitled "Advancing subsidy reform: towards a viable policy package", p. 171.

[16] See United Nations Environment Programme, *Convention on Biological Diversity* (Environmental Law and Institution Programme Activity Centre), June 1992.

[17] General Assembly resolution 54/196.

[18] A/AC.257/12.

[19] These sectors include major agricultural staple foods products, fruit, vegetables, fish etc.; the food industry; textiles and clothing, footwear, leather and travel goods, and the automotive sector, as well as a few other transport and high technology goods such as consumer electronics and watches.

[20] According to Special Study 4 "Trade and Environment" by the World Trade Organization (available at *http://www.wto.org/english/tratop_e/envir_e/environment.pdf*, p. 4), developed countries' share of polluting industries has remained more or less constant (at about 75-80 per cent) in recent decades and has even increased marginally in the 1990s.

[21] Pre-tenth session of UNCTAD seminar on FDI and sustainable development, Palais des Nations Unies, Geneva, November 1999 (see *http://www.unctad-10.org/index-en.htm*).

[22] Well-known examples include subsidies for energy, agriculture, and fishing, which aggravate pollution and resource degradation.

[23] See *http://www.wto.org/english/tratop_e/envir_e/edis00_e.htm*.

[24] See *Legal Instruments Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, done at Marrakesh on 15 April 1994* (GATT secretariat publication, Sales No. GATT/1994-7).

[25] Principle 15 of the Rio Declaration on Environment and Development (*Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992*, vol. I, *Resolutions Adopted by the Conference* (United Nations publication, Sales No. E.93.I.8 and corrigendum), resolution 1, annex I).